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PARIS FOR USOECD AND JAMES SHINN

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SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE: REVIEW
OF JAPAN

REFS: (A) PARIS 18851, (B) STATE 95449,

(C) TOKYO 10957

1. SUMMARY. MAJOR COMMON ELEMENT WE NOTE IN REAL
GROWTH FOR CY78/I AND PREVIOUS TWO YEARS' FIRST
QUARTERS IS STRONG NET EXPORTS AND RECEIPTS. CONTINUING

LARGE SURPLUS WILL CONTINUE TO PUT PRESSURES ON THE WORLD TRADING SYSTEM. EFFORTS TO REDUCE THE SURPLUS MUST BE CONTINUED, WITH ATTENTION TO INCREASED IMPORTS, CURTAILING EXCESSIVE OFFICIAL EXPORT CREDIT COMPETITION, AND IMPLEMENTING DE FACTO UNTYING OF AID. END SUMMARY.

2. REF B SHOULD REMAIN BASIS FOR MISSION'S COMMENTS IN JAPAN REVIEW. ADDITIONAL COMMENTS ON LATEST STATISTICS AND DEVELOPMENTS ARE PROVIDED BELOW.

3. GENERAL. EXPANDING ON SECRETARIAT'S NOTE ON SIMILAR

RATES OF GROWTH IN CY 78/I AND CY 77/I, WE WOULD ADD THAT SAME PATTERN WAS ALSO PRESENT IN 1976, VIZ.

GROSS NATIONAL EXPENDITURE (IN 1970 PRICES, S.A.)
(PERCENT CHANGE FROM PREVIOUS PERIOD)

CY 76 77 78

I 2.3 2.1 2.4

II 1.5 1.7

III 0.4 0.4

IV 0.8 1.1

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4. MAJOR COMMON ELEMENT WE FIND IN GROWTH THIS YEAR AND IN TWO PREVIOUS YEARS IS NET EXPORTS AND RECEIPTS, VIZ.

NET EXPORTS AND RECEIPTS (BILLIONS OF YEN, '70 PRICES, SA)
(PERCENTAGE OF GNP IN PREVIOUS PERIOD SHOWN IN PARENTHESES)

CY 76 77 78

I 4,625 (5.0) 6,208 (6.3) 7,302 (7.0)

II 5059 (5.3) 6,311 (6.3)

III 4,817 (4.9) 6,629 (6.5)

IV 5,146 (5.3) 6,459 (6.3)

5. ALTHOUGH WE AGREE WITH SECRETARIAT (REF A, PARA 5) THAT 1977 EXPORT VOLUME RISE WAS NOT STRONG, WE NOTE THAT IT CAME ON TOP OF A VERY STRONG INCREASE IN 1976:

MOF INDEX OF	EXPORT VOLUME	IMPORT VOLUME
(1970 EQUALS 100)	(1970 EQUALS 100)	
1976	198.8 (PLS. 23.3PCT.)	136.3 (PLUS 10.4 PCT)
)		
1977	204.8 (PLS. 3.0 PCT.)	141.0 (PLS. 3.4PCT.)

SOURCE: NICHIGIN. KEIZAI TOKEI NENKAN. 1977.

6. RESULT HAS BEEN THAT CURRENT ACCOUNT SURPLUS HAS INCREASED SHARPLY IN YEN TERMS AS WELL AS DOLLAR TERMS:

FY C.A. SURPLUS (BILLION YEN, CURRENT PRICES)

1975	144.5
1976	1,469.7
1977	3,653.2

SOURCE: KEIZAI TOKEI NENKAN. 1977. AND TOKYO 10176

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7. LOOKING AT OTHER ELEMENTS OF REAL GNP, WE NOTE THAT

REAL PRIVATE HOUSING IS UP 6.9 PECT. (CY78/I OVER CY77/IV, SA),
AND GOVERNMENT INVESTMENT IS UP 2.4 PCT.. PRIVATE
CONSUMPTION INCREASED AT A 2.1 PCT. CLIP, BUT PRIVATE
PLANT AND EQUIPMENT INVESTMENT GREW AT ONLY 0.9 PCT .
NOTE THAT PRIVATE CONSUMPTION AND PLANT AND EQUIPMENT
INVESTMENT TOGETHER ACCOUNT FOR ABOUT 67 PCT. OF GNP, SO
THAT GROWTH RATES IN THESE TWO SECTORS ARE VERY IMPORTANT
IN OVERALL GNP GROWTH.

8. CY 78/I INDICATORS OF AGGREGATE OUTPUT AND DEMAND
LOOK GOOD COMPARED WITH CY 77/I, BUT ARE GENERALLY
LOWER THAN CY 76/I (EXCEPT FOR GOVERNMENT AND
PUBLIC CONSTRUCTION ORDERS (REF C)

9. WITHOUT PROBING FURTHER INTO DETAILED STATISTICS
AND ECONOMIC INDICATORS, IT WOULD APPEAR THAT
JAPAN'S CUHM SURPLUS WILL PROBABLY CONTINUE
AS LONG AS SAVINGS EXCEED INVESTMENT IN JAPAN, THAT IS,
AS LONG AS DOMESTIC DEMAND IN JAPAN IS WELL BELOW

POTENTIAL. SECRETARIAT NOTED THAT CAPACITY UTILIZATION

WILL HAVE TO INCREASE SIGNIFICANTLY BEFORE NON-
RESIDENTIAL PRIVATE INVESTMENT WILL PICK UP. SECRETARIAT
ALSO NOTED THAT PRIVATE CONSUMPTION IS A BIG QUESTION
MARK. THIS SUGGESTS THAT EXCESS OF SAVINGS OVER
INVESTMENT WILL CONTINUE; GOVERNMENT SPENDING MAY TAKE
UP SOME OF THE SLACK, BUT GOJ FISCAL RESTRAINT MAY PUT
A LIMIT ON THIS.

10. PERSONAL SAVING AS A PERCENT OF DISPOSABLE INCOME

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APPEARS TO BE FALLING. STARTING FROM 20.4 PCT. IN
1970, IT PEAKED AT 25.7PCT. IN 1975 AND WAS 22.8PCT. IN 1977.

A MAJOR FACTOR IN THE HIGH SAVINGS RATE MAY BE THE LOW LEVEL OF JAPANESE NATIONAL GOVERNMENT CONTRIBUTIONS TO SOCIAL OVERHEAD. FOR EXAMPLE, GOVERNMENT TRANSFER PAYMENTS IN 1970-72 AVERAGED 4.5PCT. OF GNP; IN 1976, THEY WERE UP TO 7.9PCT. OF GNP, A STRONG INCREASE, BUT STILL BELOW THE 12.4PCT. 1970-72 UNWEIGHTED AVERAGE OF RATIOS FOR FRANCE, US, UK, FRG, AND ITALY. IN BRIEF, SOCIAL OVERHEAD EXPENDITURES, CONSIDERED POLITICALLY ESSENTIAL IN OTHER INDUSTRIAL DEMOCRACIES, ARE RELATIVELY LOW IN JAPAN.

11. COUPLED WITH LOW LEVEL OF TRANSFER PAYMENTS IS LIMITED DEVELOPMENT OF A SYSTEM OF PERSONAL CREDIT, WHICH ENCOURAGES JAPANESE CITIZENS TO SAVE, PARTICULARLY THROUGH GOVERNMENT POSTAL SAVINGS ACCOUNTS, AT VERY HIGH RATES IN AN EFFORT TO MAKE CAPITAL PURCHASES, PROVIDE FOR HIGHER EDUCATION, POOR HEALTH, OR RETIREMENT.

12. RELATIVELY LIMITED RANGE OF CHOICE OF FINANCIAL ASSETS CAUSES MOST (69) OF JAPANESE PERSONAL FINANCIAL ASSETS TO BE HELD IN CASH, DEMAND DEPOSITS OR SAVINGS DEPOSITS, WHERE THEY HAVE PROVIDED JAPANESE BANKS AND INDUSTRY WITH A STRONG AND STEADY FLOW OF CAPITAL.

13. MISSION MAY NOTE THAT EXTERNAL EQUILIBRIUM WILL PROBABLY NOT BE ACHIEVED WITHOUT INTERNAL EQUILIBRIUM AND INQUIRE AS TO PROSPECTS FOR INCREASING DOMESTIC CONSUMPTION AS A DRIVING FORCE IN THE JAPANESE ECONOMY, REDUCING SAVINGS, ETC. (DRAWING ON REF B).

14. SAVINGS AND TAX CUTS. SECRETARIAT STATES (REF A, PARA 2) "INCREAS SAVINGSRATE HAS ABSORBED LIMITED OFFICIAL USE LIMITED OFFICIAL USE

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SUBSTANTIAL PORTION OF TAX CUTS." NOTE THAT

PERSONAL SAVINGS AS A PERCENT OF DISPOSABLE INCOME HAS ACTUALLY DECLINED AND THAT EFFECTS OF TAX CUTS SHOULD NOT BE UNDERESTIMATED, -- PARTICULARLY SINCE SEVERAL JAPANESE ECONOMISTS HAVE ARGUED THAT INCOME TAX REBATE OF LAST JULY-AUGUST ACTUALLY INCREASED SALES AT THE RETAIL LEVEL.

/

	1974	1975	1976	1977
SAVINGS RATIO	25.7	25.1	24.3	22.8

15. YEN APPRECIATION. NOTE ALSO THAT JAPAN'S MEMORANDUM PREPARED FOR THE ANNUAL REVIEW TWICE MENTIONS THE "ADVERSE EFFECTS ON THE JAPANESE ECONOMY

OF RAPID YEN APPRECIATION". WHILE THERE MAY BE SOME MODEST ADVERSE EFFECTS, WE DOUBT THAT THE EFFECT IS AS LARGE AS THE GOJ MAY BELIEVE. FURTHER STIMULUS TO DOMESTIC DEMAND, AIMING AT MOVING TOWARD INTERNAL EQUILIBRIUM, PUTTING SAVINGS AND INVESTMENT MORE IN BALANCE, COULD OFFSET APPRECIATION EFFECTS.

16. IMPACT OF ADJUSTMENT POLICIES. MISSION MAY WANT TO ASK FOR GOJ ANALYSIS OF IMPACT OF TWO JAPANESE ADJUSTMENT POLICIES ON THE CURRENT ACCOUNT SURPLUS. THE "STRUCTURALLY DEPRESSED INDUSTRIES LAW" PROVIDES FOR THE SETTING UP OF CARTELS TO SCRAP EXCESS CAPACITY AND RESTRICT NEW CONSTRUCTION OF FACILITIES IN

DESIGNATED INDUSTRIES. (SO FAR: SMALLER STEEL MAKERS, ALUMINUM SMELTING, SYNTHETIC FIBERS, SHIP-BUILDING). THE "HIGH-YEN COUNTERMEASURES LAW" PROVIDES FOR LIMITED OFFICIAL USE
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UP TO \$1 BILLION THROUGH THREE SMALL BUSINESS PUBLIC FINANCE CORPORATIONS (SIMILAR TO SMALL BUSINESS ADMINISTRATION) FOR LOANS TO SMALL AND MEDIUM EXPORT-ORIENTED FIRMS (UNDER 300 EMPLOYEES) HIT BY YEN APPRECIATION. TERMS OF LOANS, AS WE UNDERSTAND THEM, INCLUDE THREE YEAR GRACE PERIOD WHEREIN NO PAYMENTS ARE DUE. ANOTHER PART OF THE PROGRAM INCLUDES TAX REBATES IF FIRMS HAVE ACTUALLY SHOWN A LOSS. WHAT IS

GOJ ESTIMATE OF TRADE IMPACT OF THESE POLICIES?

17. BANKRUPTCIES. JAPANESE ANALYSTS OFTEN ATTRIBUTE THE "HIGH RATE OF BANKRUPTCIES" IN JAPAN TO THE IMPACT OF YEN APPRECIATION. WE WOULD APPRECIATE KNOWING BASIS FOR THIS ASSERTION. ARE FIGURES AVAILABLE ON THE EXPORT DEPENDENCE (RATIO OF EXPORT SALES TO TOTAL SALES) OF THE BANKRUPT COMPANIES? WE WONDER IF MOST OF THE FIRMS ARE NOT MOSTLY DOMESTIC-ORIENTED AND GOING BANKRUPT BECAUSE OF WEAK FINAL DOMESTIC DEMAND IN JAPAN.

18. SECRETARIAL CONCLUDES (REF A, PARA 9) THAT SURPLUS IS IMPORTANT ELEMENT OF SERIOUS DISTORTIONS THAT CHARACTERIZE THE WORLD TRADE AND MONETARY SCENE, BUT THAT NO SUBSTANTIAL REDUCTION CAN BE EXPECTED IN THE FUTURE. OUR UNDERSTANDING WAS THAT CURRENT ACCOUNT SURPLUS OUTLOOK ASSOCIATED WITH 7 PCT. GROWTH OBJECTIVE IN FISCAL 1978 WAS \$6 BILLION.

19. CAPITAL EXPORTS. CAPITAL EXPORTS IN THE FORM OF

LOANS, INVESTMENTS, ETC., DO NOT ADDRESS THE PROBLEMS
CREATED BY JAPAN'S LARGE SURPLUS. HOWEVER, WE HAVE
WELCOMED JAPAN'S INTENT TO DOUBLE AND UNTIE ITS AID.
WE HOPE JAPAN WILL JOIN US IN TAKING THE LEAD IN
CUTTING BACK ON AGGRESSIVE OFFICIAL EXPORT CREDIT
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POLICIES, ONE EXAMPLE OF WHICH IS PROVIDING OFFICIAL
EXPORT CREDITS FOR LOCAL COSTS OF PROJECTS FINANCED BY
NATIONAL EXIMBANK LOANS. NEWSOM

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